



Testimony of Roger W. Little
 Deputy Commissioner, Credit Unions
 Office of Insurance and Financial Services
 on behalf of the
 National Association of State Credit Union Supervisors
 before the
 Subcommittee on Financial Institutions and Consumer Credit
 House Financial Services Committee
 March 14, 2002

NASCUS History and Purpose

Mr. Chairman and members of the Subcommittee, I am Roger W. Little, Deputy Commissioner, Credit Unions, of the Office of Insurance and Financial Services of the State of Michigan. I appear today on behalf of the National Association of State Credit Union Supervisors (NASCUS).

NASCUS has been in existence since 1965 and represents all 48 state and territorial credit union supervisors who regulate more than 4,300 state-chartered credit unions. In addition, nearly 800 CEOs of state-chartered credit unions that have a keen interest in protecting and enhancing the dual system for chartering and supervising credit unions are members of our Credit Union Council.

I serve as Vice Chairman of the NASCUS Board, am a CPA, have been both a bank and credit union regulator and served as a CSBS representative on a team to develop joint bank examination programs with the FDIC and the Federal Reserve.

Not unlike my 47 counterparts in state government, the Michigan Office of Insurance and Financial Services is committed to carrying out its mission through efficient and effective chartering, regulation and supervision of state-chartered credit unions within the statutory requirements and prudent industry standards. We serve the public through responsible regulation, effective administration and the vigorous enforcement of state laws.

NASCUS is supportive of your efforts to reduce the regulatory burden on all depository institutions and appreciates this opportunity to present the state regulators' perspective and views

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on those aspects of the regulatory relief bill (the Committee draft dated March 5, 2002) that would directly impact state-chartered credit unions.

Our testimony on this legislation is limited to a discussion of two specific provisions contained in the regulatory relief legislation. Then we would like to address the broader issue of the safety and soundness of the state credit union system.

Specific Provisions Affecting State-Chartered Credit Unions

There are two provisions of the regulatory relief bill that NASCUS would like to address. The first is the language that would authorize Federal Home Loan Bank membership for non-federally insured credit unions.

NASCUS strongly supports the provisions contained in the Regulatory Relief legislation that would authorize state-chartered privately insured credit unions to be eligible for membership in the Federal Home Loan Banks.

Today, there are approximately 375 credit unions that are non-federally insured. All of these credit unions are regulated and examined by agencies of state governments to assure that they are operating in a safe and sound manner. Regulatory functions are the primary determinant of the safety and soundness of a credit union. The function of the credit union regulator is to assure consumers that their deposits are safe. The credit union regulator performs this mission by:

- issuing rules to assure safe and sound financial practices in credit unions;
- ensuring that violations of those safety and soundness rules are corrected;
- undertaking safety and soundness examinations of credit unions under their supervision;
- requiring the remedy of any financial deficiencies uncovered during the examination process; and
- taking enforcement actions to assure that financial remedies are implemented by the credit union (including letters of understanding and agreement, closure of the credit union, etc.).

To protect credit union shareholders both federal and private share insurance systems have been established. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. Most state credit union agencies utilize the NCUA/AIRES examination platform when they examine state-chartered credit unions for safety and soundness purposes. NASCUS agencies participate in the development and testing of NCUA's examination program and procedures. In short, there is excellent working relationship and substantially similar examination standards for both federally and state-chartered credit unions.

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These non-federal insurers, primarily American Share Insurance on the mainland and a cooperative insurance fund that insures credit unions in Puerto Rico, have established additional solvency standards to minimize risks to their coverage portfolios from these credit unions.

With regard to privately insured credit unions, it is important to note that the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that would offer private deposit insurance to credit unions and for credit unions which would opt for private deposit insurance.

FDICIA also requires that privately insured credit unions must be certified to meet eligibility requirements for federal deposit insurance. Specifically, the Act states that no depository institution which lacks federal deposit insurance may use “the mails or any instrumentality of interstate commerce to receive or facilitate receiving deposits, *unless* the appropriate supervisor of the State in which the institution is chartered has determined that the institution meets all eligibility requirements for Federal deposit insurance... .” (Emphasis added) As a practical matter, this requirement applies to every state-chartered, privately insured credit union, as every such credit union uses some instrumentality of interstate commerce or the mails.

FDICIA also spells out the manner and extent to which institutions opting for private deposit insurance are required to fully disclose that their deposits are privately insured.

Therefore, there should be no concern that these credit unions are not operated in a safe and sound manner.

Included in our testimony is a table that contains a comparative analysis of the financial performance of federally chartered credit unions, state-chartered federally insured credit unions and state-chartered non-federally insured credit unions. The data will demonstrate that the financial performance and safety and soundness of all three groups of credit unions are substantially equivalent.

Permitting non-federally insured institutions to join the FHLBank System would not establish a new membership principle for the System. More than 50 insurance companies, chartered and regulated by state governments, are now members of these Banks. Allowing FHLBank membership to these credit unions specializing in housing finance would not inflict any new or unusual exposure on the Bank System.

Moreover, each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is “credit worthy.” In addition, every advance is secured by marketable collateral. Indeed, even during the savings and loan debacle, we

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understand that no Federal Home Loan Bank suffered a loss on advances extended to their members.

In the past, Congress has expanded the membership eligibility for the Bank System as a mechanism to help local financial institutions meet the housing and home ownership needs of their communities. The inclusion of this provision, enabling state-chartered, privately insured credit unions to be eligible to join the FHLBank System, is merely one more step in bringing home ownership opportunities to these credit union members.

We would appreciate your support for including this proposal in the Regulatory Relief legislation and urge the Committee to approve this provision which will help achieve our nation's housing and home ownership goals.

Exemptions From Broker-Dealer Registration Rules

Another provision of the regulatory relief package would give savings institutions parity of treatment with commercial banks with regard to exemptions from SEC registration requirements that banks were provided by the Gramm-Leach-Bliley Act. NASCUS requests that state-chartered credit unions be accorded parity of treatment with commercial banks and savings institutions, and, therefore, relief from the same SEC requirements that have been accorded to commercial banks and would be accorded to savings institutions under this bill. We understand that the NCUA has endorsed a proposed amendment to the Regulatory Relief legislation that would grant this parity of treatment to all federal and state, federally-insured credit unions and has submitted language to the Committee to achieve these purposes. NASCUS would urge the Committee to approve such a provision for all state-chartered credit unions.

Our concern is that, unless state-chartered credit unions, both federally-insured and privately insured, are accorded the same SEC treatment as commercial banks and savings institutions, the powers granted credit unions by state legislatures and by state regulators will be unnecessarily preempted by SEC regulation. Otherwise, these credit unions will be subject to redundant and costly examination and oversight.

NASCUS urges Congress to extend the same specific exemptions that are proposed for savings associations and savings banks to the nation's state-chartered credit unions. Sufficient expertise for these purposes resides in the offices of the state regulator who regulates state-chartered credit unions.

It should be clearly understood that the amendment proposed specifically extends only to those activities that state-chartered credit unions are otherwise authorized to engage in under relevant chartering statutes and do not create any new powers for state-chartered credit unions.

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Recent Concerns About Lack of “Parity” in the Credit Union Dual Chartering System

We understand that some federally chartered credit unions have complained that state-chartered credit unions have grown faster than their federal counterparts in some states in recent years. As a result it has been suggested that the powers of state-chartered credit unions might be “rolled back” by the U.S. Congress to restore “growth parity” in the dual chartering system.

The facts about relative growth of the assets of the two systems – federal and state – are correct. In recent years, a number of federally-chartered credit unions have switched to state charters because that charter offered a better fit with the business plan of those credit unions. Either there were specific consumer financial services that a particular state law or regulation permitted or there was a better field of membership provision in that state for that credit union. In other cases, there have been conversions from state to federal charters. However, the number of both state-chartered credit unions and federally chartered credit unions continues to steadily decline. Moreover, the numbers of such conversions from federal to state charters have not been significant enough to “tilt the playing field,” or create any persistent lack of “parity” or imbalance between the two chartering systems.

Indeed, today there are fewer state-chartered credit unions than federally chartered credit unions, 4,400 versus 6,200. Moreover, the total assets of state-chartered credit unions are only \$231B, substantially less than the \$270B in total assets that federal credit unions hold. Finally, it is not likely that there will be any massive numbers of conversions that would weaken, in any way, the federal credit union system.

Some have suggested that the recent rapid growth of the state system is the result of regulatory laxity by state credit union supervisors.

We vigorously challenge that contention and would like to take this opportunity to refute it.

Safety and Soundness of the Federal and State Credit Union Systems

We have attached to our testimony a brief comparison of key financial performance characteristics of the federally chartered and state-chartered credit union industries. The current data indicates that, in every essential safety and soundness category, the financial performance of state-chartered credit unions is as sound as that of federally chartered institutions. The key indicators of financial health show the following.

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At the end of 2001:

- The capital ratio of federal credit unions was 11.08%.
- The capital ratio of state-chartered federally insured credit unions was 10.74%.
- The capital ratio of state-chartered, non-federally insured institutions was 11.24%.

In short, their capital ratios were roughly the same.

- The Return on Average Assets (ROAA) for federal credit unions was 0.98%.
- The ROAA for state-chartered, federally insured credit unions was also 0.98%.
- The ROAA for state-chartered, non-federally-insured institutions was 1.19%.

In short, their ROAA ratios were roughly the same.

Finally, as the attached data demonstrates, all of the major asset quality indicators for these three groups of credit unions are roughly the same.

Moreover, the recent expansion of fields of membership for both federal and state-chartered credit unions has diversified geographical risks for many credit unions, enhancing the safety and soundness of these institutions. Credit unions with more diversified membership bases are growing more rapidly than credit unions with narrow fields of membership, often tied to employees of a single or a few local employers, and this results in a stronger and safer system.

Indeed, if we look at the origins of the Federal Credit Union Act in 1934, the practice of limiting many credit union memberships to a single, small, local employer was, in retrospect, an unsafe and unsound chartering policy. It is amazing that so many of these limited membership financial institutions survived and thrived over the years of the depression and World War II. Many of those that did survive succeeded because they were able to diversify their membership bases.

In the state-chartered credit union system, which began in the early 1900s, state legislatures were in the forefront in diversifying credit union fields of membership. Just as farmers have warned us about putting all of our eggs in one basket, regulators at both the federal and state level have come to understand that there is generally value in mixing employees in the field of membership of credit unions. Encouraging diverse employee groups and making community groups eligible for membership help ensure the economic viability of credit unions.

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In addition, we should not forget some important lessons of commercial banking history. As financial analysts have pointed out, most of the commercial bank failures in the 1920's and 1930's occurred in unit banking states where commercial banks were not permitted to diversify geographically and, as a result, were prisoners of the local economy. As a result, these banks with highly restrictive customer bases failed because their safety and soundness was severely impacted by the economic misfortunes of their local economies.

Safety and Soundness of Regulation of State-Chartered Institutions

Moreover, there have been major improvements of state systems of supervision and regulation of all depository institutions since the savings and loan debacle of the 1980's and early 1990's. Since 1998, credit unions have been subject to PCA requirements that exceed those of commercial banks and savings institutions. As mentioned earlier, almost every state supervisor of credit unions utilizes the NCUA/AIRES examination platform to assure that all risks to the National Credit Union Share Insurance Fund (NCUSIF) are minimized. Finally, the federal share insurance fund has the right to perform insurance examinations if any aspect of the financial performance of a federally insured state-chartered is questionable.

Protecting the Dual Chartering System for Credit Unions

We would submit that any public policy "prescription" to roll back, by federal law, the statutes and regulations of the states to punish state-chartered credit unions for their financial success in this new era of intensified state supervision would be a disastrous public policy approach.

Ebbs and flows in federal-state charter activity are one of the benefits of the dual chartering system. It happens in the commercial banking industry and also occurs in the credit union industry. That ebb and flow in charter activity is a desirable public policy objective, not a cause for Congressional concern.

Attempting to roll back the powers of state-chartered credit unions would be extremely damaging to the dual chartering system, to millions of credit union members and to the health and viability of the credit union system and the financial system.

We urge this Committee to protect and enhance the viability of the dual chartering system for credit unions and to approve the provisions we have discussed in our testimony.

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	Fed Chartered Fed Insured 6118	State Chartered Fed Insured 3866	State Chartered Not Insured 123	Total
FINANCIAL PROFILE				
Dec 2001 (YTD)				
Balance Sheet:				
Total assets.....	270,125,287	231,280,219	6,496,855	507,902,361
Percent change in total assets.....	15.27%	19.82%	15.50%	17.30%
Trading securities.....	244,765	49,478	0	294,243
Available-for-sale securities.....	24,113,640	19,844,759	377,001	44,335,400
Held-to-maturity securities.....	15,949,084	11,521,135	319,512	27,789,731
Total investments.....	62,285,489	49,771,504	1,570,276	113,627,269
Total loans & leases.....	168,849,330	150,688,622	4,125,400	323,663,352
Allowance for loan & lease losses.....	1,476,268	1,325,593	33,740	2,835,601
Total borrowings.....	2,704,628	2,350,493	556	5,055,677
Total shares & deposits.....	235,202,517	201,807,380	5,733,590	442,743,487
Total loans/Shares & deposits.....	71.79%	74.67%	71.95%	73.10%
Capital:				
Total equity.....	29,940,378	24,832,004	730,348	55,502,730
Equity capital/Total assets.....	11.08%	10.74%	11.24%	10.93%
Profitability:				
Net income(loss).....	2,470,349	2,086,221	72,145	4,628,715
Return on average assets.....	0.98%	0.98%	1.19%	0.98%
Return on average equity.....	8.65%	8.96%	10.31%	8.81%
Yield on average earning assets.....	6.89%	7.07%	7.40%	6.98%
Cost of funds.....	3.79%	3.96%	3.93%	3.87%
Net interest margin.....	3.60%	3.62%	3.98%	3.61%
Noninterest income/Average assets.....	1.02%	1.12%	0.89%	1.06%
Noninterest expense/Average assets.....	0.00%	0.00%	0.00%	0.00%
Number of full-time employees.....	95,013	80,350	2,161	177,524
Number of part-time employees.....	16,907	15,915	398	33,220
Asset Quality:				
Provision for losses on interest-bearing assets.....	808,293	751,974	19,807	1,580,074
Allowance for loan & lease losses/Total loans.....	0.87%	0.87%	0.81%	0.87%
Allowance for loan & lease losses/Total delinquent Loans & leases.....	93.80%	89.47%	86.57%	91.64%
Net charge-offs(recoveries)/Average loans..	0.58%	0.59%	0.55%	0.58%
Delinquent loans/Equity capital & allowance for loan & lease losses.....	4.46%	5.11%	4.63%	4.76%
Earnings coverage of net charge-offs.....	343.61%	334.29%	416.69%	340.15%
Fair value of held-to-maturity securities/Amortized cost.....	101.58%	101.27%	101.10%	101.44%
Unrealized gains (losses) on securities held-to-maturity.....	251,338	146,553	3,511	401,402
Liquidity:				
Interest-earning assets/Interest-bearing liabilities.....	119.31%	117.92%	117.73%	118.66%

All \$'s are in thousands

	Fed Chartered Fed Insured 6118	State Chartered Fed Insured 3866	State Chartered Not Insured 123	Total
SNAPSHOT				
Dec 2001 (YTD)				
BALANCE SHEET				
ASSETS				
Cash.....	28,533,308	21,936,628	571,565	51,041,501
Investments.....	62,285,489	49,771,504	1,570,276	113,627,269
Loans & Leases - Net.....	168,849,330	150,688,622	4,125,400	323,663,352
Other assets:				
Other Real Estate Owned.....	48,676	44,809	2,892	96,377
Land & Building.....	3,649,058	3,485,515	95,360	7,229,933
Other Fixed Assets.....	1,189,055	1,070,533	26,623	2,286,211
NCUA Share Insurance Capitalization				
Deposit.....	2,040,077	1,770,505	17,124	3,827,706
Other Assets.....	3,530,220	2,512,152	87,620	6,129,992
TOTAL ASSETS.....	270,125,287	231,280,219	6,496,855	507,902,361
LIABILITIES				
Borrowings.....	2,704,628	2,350,493	556	5,055,677
Accrued Dividends & Interest Payable on				
Shares & Deposits.....	444,316	310,262	3,998	758,576
Accounts Payable & Other Liabilities....	1,839,650	1,982,644	28,369	3,850,663
Shares & Deposits.....	235,202,517	201,807,380	5,733,590	442,743,487
TOTAL LIABILITIES.....	240,191,111	206,450,779	5,766,513	452,408,403
EQUITY.....	29,940,378	24,832,004	730,348	55,502,730
TOTAL LIABILITIES, SHARES & EQUITY.....	270,125,287	231,280,219	6,496,855	507,902,361
STATEMENT OF INCOME				
Interest Income:				
Interest on Loans.....	13,692,337	12,117,984	349,544	26,159,865
Less: Interest Refunded.....	17,198	13,363	13,547	44,108
Income from Investments.....	3,850,640	3,002,497	89,629	6,942,766
Trading Profits & Losses.....	6,621	30,453	0	37,074
Total Interest Income.....	17,566,796	15,164,297	452,720	33,183,813
Interest Expense:				
Dividends on Shares.....	8,276,725	5,546,729	190,080	14,013,534
Interest on Deposits.....	0	1,729,592	19,264	1,748,856
Interest on Borrowed Money.....	112,972	117,330	78	230,380
Total Interest Expense.....	8,389,697	7,393,651	209,422	15,992,770
Provision for Loan & Lease Losses.....	808,293	751,974	19,807	1,580,074
Net Interest Income After Provision for				
Loan & Lease Losses.....	8,368,806	7,018,672	223,491	15,610,969
Noninterest Income.....	2,580,132	2,368,974	53,908	5,003,014
Noninterest Expense.....	8,478,589	7,301,425	205,254	15,985,268
Net Income (Loss).....	2,470,349	2,086,221	72,145	4,628,715

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